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Economic Globalization and Social Stabilization:

A Dual Challenge for Korea

Werner Pascha¹

1. The new debate on the social cushioning of economic change

In recent years, „globalization" or „growing international economic interdependence", which we will use as synonyms here, has generally been understood as offering many opportunities for newly industrialized economies like Korea (here used as an abbreviation for Republic of Korea or South Korea). However, serious challenges are also associated with it. Whereas some time ago, the renowned „citadels" of learning and policy consulting have taken little notice of this darker side of economic internationalization, recently the perception seems to have changed. In its May 1997 *World Economic Outlook*, the International Monetary Fund (IMF 1997) extensively discussed the opportunities and challenges of globalization, concentrating on the latter. And the Washington-based Institute for International Economics has begun to publish a couple of books, attempting to „provide an objective and thorough reassessment of the case for and against globalisation" (Bergsten 1997: vii). The institute, which was frequently quite perceptive of upcoming intellectual and political moods in recent years, suspects that - in the words of its director, C. Fred Bergsten - „the United States will soon engage in a fundamental debate on the country's trade, and perhaps its overall international economic policy".

This debate could well spill over into other countries, among them Korea. This holds in particular, because due to its rapid and successful development, Korea now definitely has to be counted among the advanced economies. OECD membership in late 1996 may be considered the "official graduation ceremony", while in spring 1997, the IMF followed up when it revised its country classification, shifting away from the old label of „industrial countries" and including Korea in the (new) group of so-called „advanced economies" (IMF 1997: 4).

¹ Prepared by invitation of the Academy of Korean Studies, Songnam/Republic of Korea.

Although graduation is evidence of success, it also implies that ever more „typical advancedeconomy-type“ problems are encountered by Korea.

The basic issue at stake is whether social groups adversely affected by globalization will demand and possibly achieve a discontinuation of the efforts towards deregulation and liberalisation, or even a return to protectionist policies. The beneficial effects of tearing down regulations and impediments to trade would then be forsaken. In a worst-case-scenario, one would re-experience the protectionism of the 1920s and 1930s, which were a backlash to the pre-World-War 1 internationalization and which eventually contributed to pave the way for World War 11. Social stabilisation is therefore asked for, to pre-empt the possible rise of such sentiments and its grave consequences.

When I talk about a „new debate“ in this context, it is certainly helpful to mention a few *caveats* to define its scope more properly. This is to make sure that applause is not invited from the wrong quarters, namely from those who will indiscriminately seek any argument to demand additional state spending and public interference into the economy, with little concern for the functional and structural conditions of a market order.

It should be pointed out that the new discourse has not yet reached the mainstream of the debate on development, let alone on development in a peculiarly Asian context. So far, it is used in the context of advanced economies like the US with relatively little public spending on social matters. The Asian Development Bank in its recent „stock-taking“ of issues in *Emerging Asia. Chances and Challenges* (1997: 267-320) still interpreted the "quality of life", i. e. topics like poverty and health, conventionally in terms of an outcome of economic growth and dependent on institutional conditions. „Preparing for globalization“ was operationalized in terms of implementing and ensuring strong and transparent legal systems, flexible labour markets, and strong financial sectors (ibid.- 33-38); social stabilization was not mentioned in this context. To some extent, this is understandable. The current challenge in most developing economies is rather to enforce good governance and modernize government, for instance by streamlining social policy and making the socio-economy more responsive to (global) market forces. In this context, the thrust of the 1997 World Development Report towards an improved and streamlined role of the state has to be appreciated (World Bank 1997, also ADB 1997: 38-43).

However, Korea's status as a newly advanced economy implies that the challenges it faces are ever more often similar to those of the leading mature economies - here the US -, rather than similar to those of the developing, industrializing economies of the region. True enough, the challenge of enhancing social stabilization may seem rather unwelcome for Korea at this point of time. There is a continuing need for further deregulation and curbing of government interference, particularly after joining OECD and getting in shape for the institutional framework provided for by the WT02. Whereas this does not immediately contradict the call for an enhanced social stabilization, both challenges ask for rather different intellectual climates. Recently, an association promoting the ideas of a liberal market economy was founded under the auspices of the Korea Federation of Industries. Whereas the thrust of such an intellectual endeavour should certainly be to make the advantages of the market known to a wider public, one hopes that it will not forget the conditions for markets to function well and the necessity to set up and safeguard these conditions, among them the need for social stabilization. Of course, there still remains the question, how social stabilization can be achieved without disrupting the mechanisms of a market economy. This will be discussed later on, after some more insights into the importance of social stabilization has been gained.

2. The case for social stabilization

It is easy enough to conjecture the negative effects of globalization (i. e., growing international interdependence) on some - certainly not all - parts of the labour force: If two types of economies exist, one with relatively abundant skilled labour (advanced countries - ACs) and the other with abundant unskilled labour (less developed countries - LDCs), an intensified international exchange would drive down the wages (and employment) of unskilled labour in ACs by way of reduced prices for unskilled-labour-intensive products, this is the outcome of a straightforward application of Heckscher-Ohlin theory, the standard model of international trade, and is intuitively plausible. The poor and underprivileged would be harmed most and would start to voice protest. Now that Korea has entered the ranks of the ACs and given its current economic problems, such feelings are surely to be expected - and they could gather political momentum.

Perhaps surprisingly, empirical studies based on mainstream economics show that supporting evidence for the expected results of globalization are difficult to come by (cf. INV 1997: 53-58). Although one does find considerable downward pressure on low-skilled labour in ACs, changes in product prices, which would be a necessary prerequisite according to theory, are of a much lower magnitude. It is therefore often thought that other developments, rapid technological progress in particular, are much more important to explain the pressure on unskilled labour in ACs. Although convincing counterevidence is equally difficult to come by, some doubts nevertheless remain about the application and the results of standard economics (cf. Rodrik 1997: 13-16): for instance, it cannot totally be ruled out that (unskilled)-labour-saving technological progress itself is to some considerable extent caused by AC firms considering the increasing competition from low-wage economies and thus is indirectly related to the underlying force of globalization.

Circumstantial evidence suggests that Korea's development experience since the 1960s supplies an illuminating case study of the forces at work and of the ambiguities involved in interpreting them. Taking income distribution as a point of departure, there was a noteworthy improvement during the 1960s. Between 1965 and 1970, the Gini coefficient decreased (i.e., improved) from 0.34 to 0.33 for instance'. Reductions in absolute and relative poverty were even more pronounced. Despite problems of reliability of data there is little doubt that the general observation is valid - notwithstanding the fact that many people suffered considerable personal hardship during that era and that the transfer of workers from agriculture and rural areas into the urban factories and neighbourhoods involved a serious feeling of discomfort for those affected. The downward shift in the Gini coefficient was due to 'the rapid increase in employment opportunities ... and the significant rise in real wages' (Kwon 1993: 59). Both were related to the development strategy of export promotion and outward orientation. In this case, the 'internationalization' of the economy meant that unskilled labour was employed in the manufacturing sector, being drawn from the agricultural sector and occupations of little marginal productivity. Although the new jobs may not have seemed particularly attractive, they were important to fight latent unemployment in the rural economy and thus improved income distribution through their positive effects on the poorer strata of the population.

² I have recently discussed these issues in Frank/Pascha 1997.

³ Here, I use data from Presidential Commission 1988: 102. Problems of this source are discussed in Kwon 1990.

During the 1970s, the Gini coefficient increased (worsened) from 0.33 in 1970 to 0.39 in 1980. The accepted interpretation is that this is due to the government-led drive into heavy industry, **which offered skilled** workers, still very scarce during that decade, a wage premium and thus raised the relative position of the educated and rather well-to-do considerably. (It is noteworthy that even during those days, absolute and relative poverty continued to decrease though (cf. Suh/Yeon n.y.: 503)). During the 1980s, there was again some improvement in income distribution. This is related to the fact that the one-sided overextension into heavy and chemical industry was corrected and that the labour movement during the latter 1980s achieved very large wage increases. In the 1990s, the distribution is thought to have deteriorated again somewhat, although I have found it difficult to trace down reliable data. At least, there is an increase of "felt-inequality" (Kwon 1993: 58). Unearned incomes and rentseeking activities, tax avoidance, etc., may indeed have grown, as is sometimes suggested. A reason behind this may be the partial liberalization and deregulation, which could have allowed for considerable windfall profits because of the asynchronicity of market opening. Due to the scarcity of reliable estimates, the public uproar in the early 1990s may, however, to a considerable extent, also be a reaction to the democratization process, which made people more sensitive and outspoken with respect to perceived unfairness.

Summing up and taking a critical look at available data for Korea, the relationship between internationalization, i. e. opening up to the world economy, and changes in the social wellbeing cannot be proven to have been particularly close. Of course, one may always try to argue that global market forces were the underlying basic factors responsible for changes taking place, hidden from eyesight by more superficial changes. Even the deterioration of income distribution due to import substitution policies in the 1970s may be interpreted in such a way, namely that this temporary turning-one's-back towards the world market was necessary to be competitive in the longer run („export promotion through (preceding) import substitution"). It seems obvious, though, that policy decisions, the nature of the production function (and the use of labour it implies) and other factors were important as well.

Be that as it may, what may be more important than knowing to what extent globalization "really" causes changes in income distribution and employment problems, is to appreciate that

many people will *believe* this to be the case, and that may be enough for causing considerable social and political disruption.

Under these circumstances, old-fashioned calls for protectionism may be able to muster new **support by presenting the** tricky issues outlined above in a distorted, one-sided manner. If government does not want to give in, it should try to cushion the impact of globalization (and other factors) on income distribution and social well-being.

Before outlining the issues involved when following such a strategy in Korea, it is helpful to briefly discuss why other possible approaches are inferior. The traditional means to achieve social stabilization in Korea can be referred to as authoritarian rule on the one hand and reliance on the institution of the family on the other. In an age of democratization, it is obvious why quieting the voice" of opposition - in A. Hirschman's sense - through repression will not work.

As for the role of the family, many developing economies and Asian countries in particular, including Korea, have so far heavily relied on it to function as a social safety net (cf. e. g., Tout 1989). There are two reasons, though, why relying on this will not be sufficient for the time to come. The first is that due to industrialization, the traditional role of the family has declined. This is not the place to discuss this in detail, so it may suffice to mention some keywords like urbanization, rural-urban migration, decrease of household size, rise of one-person households, educational and lifestyle gaps between the generations, rising expectation of life vs. decreasing number of children, which are relevant in this context. Certainly, the traditional system of supplying welfare for the aged and sick through the family system has not broken down so far.

However, one may conjecture that this is not because the factors above are not making any impact or that they do not work in a Korean context. Rather, it seems that a considerable time gap has to be acknowledged. For instance, till recently the income-earning generation, which has to make the decisions on what to spend on family welfare, still shared the experience of a deprived youth and the childhood memory of the Korean War, in which family assistance was the only means of supplying help under existentially life-threatening circumstances. It is understandable that the old family values stay deeply ingrained in this generation despite of secular forces working in another direction. A major and growing part of the younger generation is raised in relative affluence, is well-educated, used to the westernised lifestyle of

the cities, possesses only faint memories of the rules and manners of traditional life in the countryside. At first slowly, but with increasing speed it will influence the social landscape, though, and one may expect considerable changes. Already today, the first sons of married couples are reported to have difficulties in finding spouses, because the young women try to avoid the obligations of taking care of their parents-in-law, etc.

The second reason for scepticism about the future role of the family is that the nature of social issues has changed under the influence of democratization and the rise of the middle class. Today, the public *perception* of whether the state takes care of social issues has become an important aspect in its own right.

3. In favour of introducing more social elements into the market economy

The government should therefore deliberately and actively try to introduce more social elements into the economy. In Germany, such a concept has been called „Social Market Economy“, and I consider it important for Korea as well⁴. As mainstream economists are very sceptical about anything containing the particle „social let me start with a few clarifications, before I explore the possible content of such an approach in the case of Korea further. In my understanding based on the readings of the „classics“ of the social market economy tradition, the concept of Social Market Economy does not consist of a fixed set of policy fields and dos and don'ts, but it is to be understood as a continuous challenge of keeping the social consequences in mind when designing (economic) policy. It does not (only) involve more active (and costly) social policy; rather, it also stresses other elements of a wider „societal policy“ (*Gesellschaftspolitik*), incorporating cultural policy and environmental policy, to mention but a few. The current excesses of German government spending on social welfare, with many ill-constructed mechanisms of contributing to its costs and sharing in its benefits, can certainly not be understood as Social Market Economy any more, as it was conceived by personalities like Ludwig Erhard or Alfred Müller-Armack in the 1940s to 1960s.

⁴ I am very grateful to the Academy for Korean Studies for having allowed me to elaborate on this issue during a visiting fellowship in 1996; for a result of this work, see Pascha 1996, 1997.

Although not all societal policy poses fiscal problems, there is of course some part - „social policy" in a more limited sense - which does involve a considerable fiscal burden. Frequently, such a „burden" is abhorred by economists for its own sake. However, it should not be underestimated that for reasons deeply entrenched in history, the citizens of many states expect their government to fulfill social obligations, stabilize the community and help the underprivileged and downtrodden. In such circumstances, spending on social policy fulfills an important function of government, which has to be weighed carefully against its opportunity costs. Such an argument, of course, holds in particular for countries in which a tradition of the state acting on behalf of the community is particularly strong. In Europe, Germany is considered such a country, with a rich tradition of cameralism and even theoretical thinking on an organic relationship between the state, the citizenry and the economy'. For Korea, with a strong background in Confucianism, the expectations of the population with respect to a benign role of the state, particularly in a period of serious economic challenges as today, cannot be disregarded either. Even in the United States, it could be shown above that the one-eyedness of the years of Reaganomics slowly fade, and more socially conscious thinking is gaining ground again⁶.

As I have argued elsewhere (cf. Pascha 1996, 1997) with respect to societal policy in Korea, I see a great need for action in the following three areas:

distribution of income and wealth,
competition,
social policy proper.

This is not the place to consider the details of such possible action. Let me summarize, instead, a couple of issues which have to be faced by policy makers and their academic advisers:

The first issue is to establish the links between globalization and the three policy arenas mentioned above more clearly. For instance, as is suggested by mainstream economic research

⁵ For an overview in English, see Riha 1985.

⁶ Renowned political and social scientist Seymour Martin Lipset argues that even the so-called American neo-conservatives have a positive attitude towards the New Deal and towards the state providing social welfare (cf. 1997: 193-202).

based on cross-country comparisons, changes in the distribution of income and growth may have less to do with internationalization than with other factors like technology. This may hold for Korea as well, as argued above. For the early 1990s for instance, the presumed worsening of wealth distribution may have more to do with regulation (taxation, registration of transactions, etc.) than with internationalization. True enough, as many citizens just unreflectingly believe that globalization is the „culprit“ in the case of pressure on distribution, the educational effect of research as outlined above may be limited. Still, such analysis is important to identify effective policy measures.

A second aspect is related to this latter point: Societal measures have to be designed in a way not detrimental to the mechanisms of globalization and the competitiveness of the economy. Consider an activation of social policy, in which case two major issues have to be faced: (a) How can taxes be raised for such activity without risking an exodus of footloose capital to seek locations with less taxation? And (b), how does one provide social welfare without serious negative side-effects like creating strong disincentives to participate in the labour market and thus risk rising unemployment ?

Ad (a): The link between globalization and taxation has been widely studied in recent years, and there is a lot of concern as to the autonomy left for individual countries to create tax systems appropriate for their domestic needs and wants (cf. Tanzi 1996). At least in the case of Korea, though, these concerns do not make a more active social policy impossible. Compared with other advanced economies, Korea still has a very low tax rate when compared to GNP. Therefore, there is considerable leeway left to devote a few percentage points more of GNP to social policy. After all, a rule that „the lower the ratio of taxes to GNP, the more competitive the economy“, can certainly not be established.

If one accepts GNP per capita as one of the few meaningful representations of the elusive concept of „competitiveness“, then it can easily be shown that *higher* GNP per capita (and thus competitiveness) is associated with a *higher* tax level and *more* openness (internationalisation) of the economy in cross-country comparisons. We read this to imply that a higher level of public spending is not incompatible with running a successful economy⁷ or, noting the

⁷ Rodrik (1997: 57-64) goes so far as to suggest that there is actually a causative effect of an economy's openness (and hence of external risk) on government expenditure. However, the theoretical basis of this

considerable variance of country data, that a given level of openness and GNP per capita is compatible with a wide range of tax levels per capita or taxation to GNP.

The real issue, therefore, is not whether a more active social policy is feasible when compared to the given GNP level, - at least as long as government expenditure is still well within **the observed range of country** experiences -, but whether the presumed negative effects on the fiscal balance, on (financial) resource utilization, on disincentives of higher taxation, etc., can be compensated or neutralized by institutional adjustment.

Designing such policies on a „drawing-board" or from an „economist's armchair" is quite difficult. It is important to keep the objectives in mind, though. Activated social policy is supposed to make globalization more acceptable. Consequently, social insurance and assistance should be geared „toward labour markets", as Rodrik (1997: 79) suggests in general. Applied to Korea, and particularly after new labour laws, policies to make lay-offs more acceptable need emphasis. This includes measures aiming at re-education, incentives for self-employment, etc. Another problem related to Korea is that although a rather large percentage of the population is covered by public assistance, the amount spent is small. Comparing the number of beneficiaries in Korea (1991), Taiwan (1986) and - for an earlier development stage - Japan (1965) and taking the small size of the government budget for social development into account, this is quite obvious: In Korea, there were 2.6 mio. beneficiaries, i.e. 6 percent of the population, compared to 0.1 mio. (0.6 %) in Taiwan and 1.6 mio. (1.6 %) in Japan (cf. Kwon: 1993: 124). This suggests that individual assistance is either small and/or very selective. It should be reconsidered to what extent public assistance - whether given in kind or in cash - really fulfills the needs which it is meant to fulfill and whether apart from formal statutory rules it is actually distributed to all those in need. Receiving such assistance should be liberated from a social stigma.

With respect to issue (b), making public assistance or social insurance payouts available should not create strong disincentives to participate in the economy. Given the current level of social spending in Korea, this danger should still be quite remote and can be controlled if mechanisms

hypothesis and the level of econometric evidence, compared to the level necessary to show causation, are not fully convincing. I therefore subscribe to a more conservative interpretation of the observable correlation between openness and government size as outlined above.

are created that do not lend themselves easily to an „automatic increase“ in case of rising income levels. It should be noted in passing that of course it also has to be ascertained that - in terms of the pursued objectives - positive effects of specific measures are not (over-) compensated by negative effects of raising the funds for those very measures. Given Korea's narrow tax base, there is a real danger that the overall effect of some socially motivated measure may turn out to be regressive, for instance (cf. Rhee 1987: 228-229).

One more consideration relevant for discussing negative side-effects (i. e., problem (b)) is the eventual reunification of Korea. In any reform of social welfare, it has to be taken into account what would happen if millions of citizens of the Korean North would suddenly have to be reckoned with. As for the German case, the simple extension of social welfare benefits to the Eastern population actually turned out to be one of the most costly aspects of reunification. There seems to be a wide-spread feeling in (South) Korea that in case of a national reunification, the North could somehow be insulated from the South - e. g. through some temporary institutional arrangement like a confederation -, thus avoiding some of the exorbitant costs experienced in Germany. It is questionable, though, whether that is a realistic assumption. Under the framework of democratization, it is difficult to "freeze" the Northern population in its place and to make sure that familial links will not be utilized to find imaginative ways to tap Southern assistance schemes. At least, Southern policy authorities should develop some contingency plans in time and appraise social policy initiatives also in the light of such possible contingencies.

Summary: Social stabilisation as a prerequisite of a dynamic advanced market economy

Summing up, let us return to the plain fact that higher per-capita incomes generally go hand in hand -allowing for considerable cross-country variation, of course - with a higher ratio of public spending, and of public spending for social issues in particular. Since the formulation of this socio-economic „quasi-law“, economists have considered many factors as to whether they are responsible for this relationship (cf. Leineweber 1988). As argued above, I do not subscribe to the view that globalization is particularly significant among these factors. Still, one should also not follow the simple liberalist position that the correlation is only due to deformations of

advancing economies, in which interest groups are heavily entrenched and in which the political system, with its equally entrenched self-interests, can easily be mobilised to hand out special favours for well-organised interest groups.

Rather, consider that higher public spending may to some extent also be due to increased public needs. A German economist has recently argued that it is an important function of social welfare spending in advanced economies to make people accept risks in the marketplace, compensating for their aversity to risk (cf. Sinn 1995). Normally, people will seek security once their incomes have reached a certain level, and they will hesitate to engage in risky entrepreneurial activities even if the expected income from such an activity is considerably higher than from a government job or from another low-risk occupation. Such an environment would be detrimental for innovation, technological and organisational progress, and structural change, it would move the economic system towards a state of sclerosis and eventual decline. In such a case, social policy may be understood as a social insurance mechanism, which motivates members of the society to engage in entrepreneurial activities. Society as a whole will profit from this activity due to the economic dynamism generated.

Low social spending in an advanced economy, if taken to extremes, therefore does not help adjusting the economy better to globalization, but worse, because it adversely affects entrepreneurial activity and thus slows down economic adjustment and innovation.

Is this kind of analysis appropriate for Korea? Actually, we may currently have reached a phase where the lack of an appropriate social policy already works against entrepreneurial dynamism in the economy at large and thus slows down the move towards higher income levels.

Consider the preference of many Koreans for well-cushioned employments in leading *chaebol* enterprises or in the government sector,
the urge for white-collar-type education,
look at the problems of small and medium enterprises to find qualified personnel or
at the lack of venture businesses.

They all may to some extent be related to the fact that given the current level of affluence, many economic actors find it unattractive to engage in risky, but potentially highly profitable activities, which could help move the economy to new levels of success in a globalized age.

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